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SUBJECT: HUNGARIAN AMBASSADOR DISCUSSES VISIT OF PRIME  
MINISTER BAJNAI TO CROATIA, REINFORCES CONCERNS ON ENERGY

Classified By: Rick Holtzapple, POL/ECON, Reasons 1.4 B/D

¶1. (C) Summary. Hungary's ambassador to Croatia, Peter Gyorkos, sat down with Pol/Econ Counselor and Econ Officer on January 22 to discuss the recent visit of the Hungarian Prime Minister to Croatia, and to explain Hungary's increasing nervousness regarding Croatia's energy relations with Russia.

Hungary was pleased that the gas interconnector between Hungary and Croatia would be completed this year, giving both Hungary and Croatia a more diverse set of options for gas supplies. He also noted significant progress in resolving issues related to MOL's takeover of the Croatian energy company INA. However, he said Hungary perceived a strong push by Russia to court Croatian participation in energy projects that could benefit Russia at Hungary's expense. In particular, he mentioned the Druzba Adria oil pipeline project and the fears that Russia had the ability to completely book the line's capacity, cutting off Hungary from supplies. He expressed cautious optimism that the liquefied natural gas facility (LNG) on the Island of Krk would begin to move forward this year. END SUMMARY.

¶2. (C) Energy was the primary subject discussed during Hungarian Prime Minister Bajnai's visit to Croatia on January ¶18. According to Hungarian Ambassador Gyorkos, Bajnai asked Prime Minister Kosor to be cautious of Russia's intentions during her planned visit to Moscow later this winter. Prime Minister Kosor will travel to Moscow, reportedly to discuss the renewal of Croatia's long term gas contract with Gazprom that expires this year, among other issues. (NOTE: Croatian media this week said that Kosor's visit to Moscow would likely occur on February 22. END NOTE.) Croatia is reportedly seeking a major increase in the quantity of Russian gas supplied. But Hungary fears Russia may see this as an opportunity to push other issues, such as undercutting the case for an LNG terminal on the Adriatic coast, or getting Croatia to sign on to an alternative route for South Stream that could cross Croatia rather than Hungary. Gyorkos noted that any land pipeline seeking to get around Ukraine on the south has to pass either through Hungary or Croatia. Prime Minister Bajnai reportedly reminded Prime Minister Kosor that Hungary had domestic gas production and large-scale storage that could help supply Croatia in a crisis. Both Prime Ministers applauded the beginning of construction of the Hungary-Croatia gas interconnector. Gyorkos said the interconnector, which is scheduled to be completed by the end of 2010, gives Hungary some real options for diversifying its gas supplies, as Hungary could access gas from any major pipeline crossing Croatia, as well as the planned LNG terminal.

¶3. (C) Gyorkos also described as positive recent developments in MOL's investment in INA of Croatia, after a series of difficulties throughout 2009. In January 2009, MOL had signed two agreements with the GoC. One was a Shareholder

Agreement that gave MOL -- which had earlier acquired the largest set of shares, although not an absolute majority -- responsibility for day-to-day operational decisions, while "strategic decisions" would have to be made by MOL and the GoC jointly, as the two biggest shareholders. That Agreement also extended until 2014 the GoC's right of first refusal for any move by MOL to sell its INA shares, something the Croatians have been eager to ensure, so as to avoid possible hostile takeover moves from elsewhere, particularly Russia.

¶4. (C) The more controversial agreement signed in January 2009, however, had been a Gas Master Agreement that committed the GoC to purchasing INA's money losing gas subsidiary. This purchase was supposed to be completed by July 2009, but the GoC balked at completing the deal, Gyorkos said, because it could not raise the needed cash, and because of internal fights between the Croatian Finance and Economy ministries. The surprise resignation of then-PM Ivo Sanader in July 2009, followed by the resignation of Economy Minister Damir Polancec over a separate controversy in the fall, further complicated INA-MOL negotiations. According to Gyorkos, the parties only resolved the issue in December 2009, aided by what he described as the "very correct" attitude of PM Kosor. The final deal left the gas subsidiary within INA-MOL at least for now, but was accompanied by a rise in the government-controlled price of gas to a level that Gyorkos said would make it financially feasible for MOL to retain the unit. Even here, however, Hungary had concerns about Russian involvement. Gyorkos argued that Russian interests were likely behind a spate of negative media coverage of MOL within Croatia. He also noted rumors, which he could not/not confirm, that Russia's Surgutneftigas, which owns 21 percent

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of MOL, had offered to swap its MOL shares for INA shares. He also complained that Surgutneftigas was not complying with Hungarian laws that required disclosure of its corporate ownership structure.

¶5. (C) Gyorkos reported that oil supplies were also of serious concern to Hungary. Currently, oil off-loaded in Croatia's ports travels the Adria pipeline to refineries in Croatia, as well as onward to Hungary, Bosnia, and Serbia. The ambassador said that if Croatia agreed to participate in the Druzba Adria project, reversing the flow of the Adria pipeline to enable Russian oil exports, then Russia could completely book the capacity of the line, export to Serbia, and elsewhere from Croatia's coast, leaving Hungary out. Econoff asked the ambassador about rumors that Russia would demand that a new gas agreement with Croatia be made contingent on Croatian participation on Druzba Adria. Gyorkos said he wasn't sure what was happening behind the scenes, but that even with different companies and different commodities, "it is always the same eye peering in from the other end of the pipeline."

¶6. (C) On the LNG terminal, Gyorkos said his prime minister had made a strong case to PM Kosor to help the project finally move forward. It was Gyorkos' opinion that the GoC's long delay in formalizing the Croatian partnership within the Adria LNG consortium was due in large part to the uncertainties over the fate of INA's gas subsidiary. As INA was to be the largest part of the Croatian partnership within the consortium, it had been difficult to finalize the composition of that partnership until the fate of INA's gas business was clear. Now that those issues appear to have been resolved and the agreement on the gas trading business signed, Gyorkos expressed cautious optimism that there would be quicker movement on the project soon. The LNG terminal's projected 10 bcm of import capacity, combined with the gas connector with Croatia, would give Hungary a welcome option for diversification of its gas supplies.

¶7. (C) Comment: The Hungarians clearly recognize that, while Croatia's market size is small, its geographic position is key to a number of projects relating to Hungary's energy

security. The Hungarian prime minister's visit brought additional political weight to the same message on diversification of energy supplies that we have given the Croatians. The difference is that, while the U.S. has few economic energy equities in Croatia, Hungary is a key energy partner for Croatia. For that reason, we expect Prime Minister Kosor will take Prime Minister Bajnai's advice and concerns seriously as she contemplates her upcoming negotiations with Russia.

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